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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1742

ZENITH LABORATORIES, INC.,
Petitioner,

vs.

CARTER-WALLACE, INC.,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Questions Presented for Review

(1) Did the Court of Appeals commit error when it held that invalidation of a patent does not give a purchaser of the patented product or a licensee a cause of action for return of the purchase price or royalties paid prior to the invalidation?

(2) Did the Court of Appeals commit error when it held in a case where jurisdiction is based solely on diversity of citizenship that a claim of common law fraud on the Patent Office does not state a private cause of action where the petitioner did not claim the alleged fraud created a restraint of trade under the antitrust laws; where petitioner expressly disavowed reliance on any federal law; where petitioner did not claim the alleged fraud was practiced on it to induce it to purchase the patented product; and where the patent was invalidated on the grounds of obviousness and not fraud?

Statement of the Case

(i) Procedural History of the Case.

Following the novel decision of the District Court in *Troxel Mfg. Co.* v. *Schwinn Bicycle Co.*, 334 F. Supp. 1269 (W.D. Tenn. 1971), *rev'd.* 465 F.2d 1253 (6th Cir. 1972), *cert. denied* 416 U.S. 939 (1974), petitioner Zenith Laboratories, Inc. ("Zenith"), initiated this suit. Zenith's initial Complaint consisted of a single count seeking monies paid to respondent Carter-Wallace, Inc. ("Carter") allegedly on account of Carter's meprobamate patent which had been invalidated on the grounds of obviousness in February, 1972.* In other words, the Complaint was grounded on the assumption that a mere purchaser of a patented product could recover part of his purchase price at any time a patent is subsequently invalidated.

* *Carter-Wallace, Inc.* v. *Davis-Edwards Pharmacal Corp.*, 341 F. Supp. 1303 (E.D.N.Y. 1972), *aff'd. on other grounds, sub nom Carter-Wallace, Inc.* v. *Otte, Trustee,* 474 F.2d 529 (2d Cir. 1972), *cert. denied,* 412 U.S. 929 (1973).

After the District Court opinion in *Troxel,* the *only* authority *ever* to espouse the legal theory which is the basis of Zenith's case, was reversed, Zenith amended its Complaint to add four "new" counts.

The Amended Complaint (hereinafter the "Complaint") did not state any federal claim. Jurisdiction was based solely on diversity of citizenship (¶1).

The first four counts of the Complaint, though based on identical facts—the purchase of meprobamate by Zenith from Carter and the subsequent holding of patent invalidity—sought recovery under various theories, including unjust enrichment, failure of consideration and mistake as to a material fact. The fifth count alleged that Carter perpetrated a fraud on the Patent Office which "affected" the grant of the patent (p. 5, ¶4). There was no allegation of fraud on Zenith, and no antitrust claim based on such alleged fraud.*

Carter then moved for dismissal and/or summary judgment. As to each of the five counts, Carter urged dismissal below as a matter of law under Rule 12(b)(6) for failure to state a claim upon which relief could be granted. There was no conceivable basis on which Zenith's claims could be distinguished from those rejected in *Troxel* and the many cases which both preceded and followed *Troxel.* On the contrary, since those cases involved licensee claims for recoupment of royalties, they applied *a fortiori* to Zenith, a mere purchaser of a patented product seeking refund of its purchase price.

* Zenith's memorandum in support of its motion for leave to amend represented to Judge Stern that Zenith was merely seeking leave to add "four additional counts, all of which seek the same relief as requested in the original Complaint . . ." i.e., the return of payments by which Carter was unjustly enriched (216a).

While the fifth count—fraud on the Patent Office—was not expressly covered by the *Troxel* holding, it was clear that it also failed to state a cause of action. No antitrust violation was alleged, and, in addition, Zenith was not a licensee of the meprobamate patent.

There were a number of other grounds requiring dismissal of the Complaint, including Zenith's violation of the compulsory counterclaim rule, the doctrine of *res judicata* and estoppel by judgment, release and the statute of limitations. Since these defenses went beyond the four corners of the Complaint, but did not raise any triable issue of fact, Carter moved for dismissal under Rule 56. The District Court dismissed the Complaint on the ground it failed to state a claim upon which relief could be granted.

The United States Court of Appeals for the Third Circuit, *following* the decisions in the Sixth and Seventh Circuits, affirmed:

> "Such suits as this one have recently been disposed of on the authority of the appellate decision in *Troxel,* 465 F.2d 1253. *Kraly* v. *National Distillers and Chemical Corp.,* 502 F.2d 1366 (7th Cir. 1974); *Ransburgh Electro-Coating Corp.* v. *Spiller & Spiller, Inc.,* 489 F.2d 947 (7th Cir. 1973)." 530 F.2d 513 (3d Cir. 1975).

(ii) The Consent Judgment and the Meprobamate Transactions between Zenith and Carter.

(a) *The Consent Judgment.*

The meprobamate patent issued to Carter on November 22, 1955. Carter licensed American Home Products, Inc. to use and sell meprobamate as a single drug in finished form. It also licensed Merck & Co. and American Cyanamid to use and sell meprobamate in specified combination products. The licensees paid Carter a royalty based upon their sales of meprobamate in the finished product form and other consideration.

In 1960, the United States Department of Justice brought an action against Carter and American Home alleging the exclusivity provisions of the Carter-American Home license agreement and asserted post-sale restrictions imposed on Merck and American Cyanamid violated Sections 1 and 2 of the Sherman Act. *United States* v. *Carter Products, Inc. and American Home Products, Inc.,* 60 Civ. 375 (S.D.N.Y. 1960).

The Government's suit was terminated by a Consent Judgment entered November 9, 1962, between the Government and Carter which, among other things, abrogated the license agreement between Carter and American Home and required Carter to sell meprobamate to all qualified pharmaceutical houses on unrestricted and non-discriminatory terms. The Consent Judgment also authorized Carter to charge up to $20 per lb. on its sales of meprobamate powder thereunder, with a provision for increases based on rises in the cost-of-living index. The Consent Judgment was approved by the Court at 211 F. Supp. 144, and became effective in early 1963.

(b) *The Meprobamate Transactions Between Zenith and Carter.*

Zenith promptly availed itself of the opportunity to purchase meprobamate from Carter under the terms, including price, authorized by the Consent Judgment. Zenith's first purchase of meprobamate from Carter occurred in August, 1963, when it purchased a small quan-

tity (7 lbs. at the authorized price of $20 per lb.).* Zenith continued to purchase meprobamate from Carter pursuant to the Consent Judgment until the fall of 1967, when it began purchasing from other sources. Zenith's last purchase from Carter was in September, 1967.

Because the Consent Judgment required that all sales of meprobamate be on "non-discriminatory terms and conditions," Carter required all sales of bulk meprobamate to be pursuant to a standard "Confirmation" form, prepared in 1963 and approved by the Department of Justice.

Accordingly, the practice followed consistently by Zenith and Carter with respect to all bulk meprobamate transactions between them was as follows: Zenith initiated its requests to purchase by sending its own form of purchase order to Carter, bearing Zenith's order number. Carter then sent a "Confirmation" to Zenith, which Zenith signed and returned to Carter which referred to Zenith's order number, and set forth the terms and conditions of the sale (23a).**

The "Confirmation" sent to Zenith for signature did not become binding on Carter until returned by Zenith with its signature as Purchaser, and acceptance by Carter as Seller. (Sigerson Affd., ¶13) (19a). They describe each transaction as a purchase and sale; describe Carter as

* These and all other pertinent details of the transactions between Carter and Zenith relating to the subject matter of this action together with a representative set of the documents by which Zenith purchased meprobamate from Carter, are contained in the Affidavit of William Sigerson, Carter's then Secretary and Counsel, sworn to September 14, 1973, in opposition to Zenith's motion for class determination on the original Complaint (15a-35a).

** All such references are to the appendix before the Court of Appeals.

the "Seller" and Zenith or other buyer as the "Purchaser"; and describe the amount paid as the purchase price (23a).

The "Confirmations" establish that the transactions between Carter and Zenith were transactions of purchase and sale, not patent license agreements; and that the amount paid was the purchase price, as expressly provided in the Consent Judgment, not a royalty. Indeed, it could not have been otherwise since Carter was enjoined by the Consent Judgment "from supplying meprobamate compound to any pharmaceutical house by means of other than a sale," or from charging a royalty (Arts. IV(E), VI (B)).

Reasons for Denying the Petition

1. There is no conflict in the uniform decisions of the Third, Sixth and Seventh Circuits.

It is settled, and has been for decades, that royalties paid by a patent licensee cannot be recovered on any theory of unjust enrichment, failure of consideration, or mistake of material fact if the patent is subsequently declared invalid. *Schwarzenbach* v. *Odorless Excavating Apparatus Co.,* 3 A. 676, 677, 65 Md. 34 (1886) contains an apt statement of the time-honored rule and its rationale:

> "[I]t has been held in several well-considered cases in England and this country, and seems to be the accepted doctrine, that in a contract for the purchase of a privilege under letters patent, the seller at the time of the purchase supposing his patent to be valid, its being pronounced afterwards by a legal tribunal not to be so *will not operate a failure of*

> *consideration.* And Curt. Pat. (4th Ed.) §216, states it has been held that a licensee who has paid an annuity in consideration of a license to use a patent privilege, *which he has had the benefit of, cannot recover back the money upon the ground of the invalidity of the patent in an action for money had and received.* The case of Taylor v. Hare, 1 Bos. & P. (N.R.) 260, fully sustained the text."*

Other early cases which applied this principle include *Headley Good Roads Co.* v. *Barber Asphalt Paving Co.,* 292 F. 119 (3rd Cir. 1923); *Drackett Chemical Co.* v. *Chamberlain Co.,* 63 F.2d 853 (6th Cir. 1933); *Galion Iron Works & Mfg. Co.* v. *J. D. Adams Mfg. Co.,* 105 F.2d 943 (7th Cir. 1939); *Warner Bros. Co.* v. *American Lady Corset Co.,* 48 F. Supp. 417 (S.D.N.Y. 1942); *Westinghouse Electric & Mfg. Co.* v. *MacGregor,* 38 A.2d 244, 250, 350 Pa. 333 (1944), *aff'd. per curiam,* 327 U.S. 758 (1946).

The reason for such a general principle is that the purchase of a patent license is nothing more than a voluntary payment by the licensee in exchange for a waiver of the patent owner's right to sue for infringement. *De Forest Co.* v. *United States,* 273 U.S. 236, 242 (1927); *General Talking Pictures Corp.* v. *Western Electric Co.,* 304 U.S. 175, 181 (1938). A subsequent declaration that the patent is invalid does not give rise to a claim to recover monies previously paid for immunity from suit.

The now reversed District Court opinion in *Troxel* (334 F. Supp. 1269 (W.D. Tenn. 1971)), interpreted this Court's opinion in *Lear, Inc.* v. *Adkins,* 395 U.S. 653 (1969), to have changed this long-standing rule. It held that *licensees* under a subsequently invalidated patent could recover the

* Unless otherwise noted, all emphasis has been supplied.

royalties they had paid under *patent license agreements* if the licensed patent was subsequently declared invalid. Other than this now rejected decision, we have found no authority, and Zenith has cited none, which would permit it to assert its claims.

The Court of Appeals for the Sixth Circuit, in reversing, found the District Court's decision in *Troxel* to be an "unwarranted extension of *Lear*" (465 F.2d at 1255).

Among the factors stressed by the Court in its opinion was the "inequitable result" of the District Court's opinion (465 F.2d at 1259), which would "discourage the licensing of patents," and encourage inventors "to keep secret an invention which otherwise might have been disclosed through the patent process" (465 F.2d at 1258).

Realistically, as the Court noted, a patent owner could not afford to license his invention since he "would have a continuous cloud over any payment of royalties made to him . . . He would be compelled to retain all royalties received in a relatively liquid state until the expiration of the licensed patent, or the running of the *applicable statute of limitations.*" (465 F.2d at 1257-58).

For these reasons, as the Sixth Circuit explained in *Atlas Chemical Industries, Inc.* v. *Moraine Products,* 509 F.2d 1, 6 (6th Cir. 1974):

> "The claim that a licensor can be 'compelled to repay all royalties received from its licensees,' *Troxel* I, 465 F.2d at 1259, . . . *was soundly rejected,* because this would give the licensee the legal equivalent of a 'heads-I-win, tails-you-lose' advantage in a license agreement. Expenditious evaluation of the patent would be defeated."

Every other Court that has considered the question has followed the reasoning and result of the Sixth Circuit in *Troxel.*

In *Ransburg Electro-Coating Corp.* v. *Spiller & Spiller, Inc.,* 340 F. Supp. 1385 (N.D. Ill. 1972), the licensee sued for recoupment of all royalties paid under a settlement agreement on a patent which the District Court there found to be invalid. The claim was summarily rejected. In affirming, (489 F.2d 974, 979 (1973)), the Seventh Circuit held:

> ". . . with respect to [the claim for recoupment of monies paid pursuant to] the license agreement the decision in *Troxel* . . . is dispositive, and we therefore hold that Spiller's claim for a refund on the license agreement should have been *summarily* denied." (489 F.2d at 979).

In *Kraly* v. *National Distillers & Chemical Corp.,* 502 F.2d 1366 (7th Cir. 1974), the Seventh Circuit affirmed a decision which ordered a patent licensee to pay royalties owed for operations under the patent for the period *prior* to the time the patent was declared invalid. In doing so, it held the District Court's application of the equitable principles enunciated by the Sixth Circuit in *Troxel* was "eminently correct." (502 F.2d at 1372).

Similarly, in the instant case, the Third Circuit continued the uniform rule of law recited in *Troxel.*

> "The reasoning of the *Troxel* appellate court is persuasive. Federal patent policy in favor of early adjudications of invalidity, it argued, would be defeated by allowing recovery of past royalties:
>
> '[S]uch an interpretation of *Lear* would make it advantageous for a licensee to postpone litigation, enjoy the fruits of his licensing agreement, and sue for repayment of royalties near the end of the term of the patent.' 465 F.2d at 1257.

> Furthermore, the prospect of refunding all royalties collected would constitute such a cloud over a licensed patent that patenting would be discouraged. Thus, *Troxel* adhered to the earlier ruling of the Sixth Circuit in *Drackett Chemical Co.* v. *Chamberlain Co.,* 63 F.2d 853 (6th Cir. 1933), that the obligation to pay royalties ends upon 'eviction' from the license by an adjudication in a court of competent jurisdiction of invalidity of the underlying patent. However, a licensee is precluded from recouping royalties already paid.
>
> We concur in the Sixth Circuit's decision in *Troxel* . . ." 530 F.2d 513 (3rd Cir. 1975).

2. There is no conflict between the policy of *Lear* v. *Adkins* and *Blonder-Tongue* and the Circuit opinions.

As is readily seen, Zenith's argument that the Third Circuit's decision conflicts with the policy or direction of *Lear* v. *Adkins* and *Blonder-Tongue, Inc.* v. *University of Illinois Foundation,* 402 U.S. 313 (1971) is not novel. It has been rejected by the Sixth, Seventh, and, now, the Third Circuit and has failed to provide grounds for certiorari when it was initially made in *Troxel.*

Zenith's position, though allegedly based on *Lear* v. *Adkins,* has nothing whatsoever to do with licensee estoppel.

In *Lear,* this Court exhaustively examined and ultimately overruled the doctrine of licensee estoppel. Estoppel had historically "muzzled" patent licensees, "often . . . the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery" (*Lear,* 395 U.S. at 670). In its opinion, this Court consciously balanced the public interest in eliminating specious patents against this technical requirement of contract doctrine. Estoppel was abolished because it came out on the light end of the delicate balance.

This Court, in *Lear,* cited *Drackett* v. *Chamberlain,* 63 F.2d 853 (6th Cir. 1933), as standing for the general rule that "licensees may avoid *further* royalty payments, regardless of the provisions of their contract, once a third party proves that the patent is invalid" (395 U.S. at 667). Petitioner chooses to ignore this general rule, and instead contends that *Lear* stands for the rule that licensees and even purchasers may *recoup* all royalties *paid* once a third party proves that the patent is invalid. *Lear* does not support such a rule.

That Zenith seeks a wholly unwarranted extension of *Lear* was recognized and clearly stated by the Sixth Circuit:

> "The public interest is protected adequately under *Lear* without imposing on the patent holder the obligation to refund royalties paid under the license of a patent procured and asserted in good faith. A licensee may at any time cease royalty payments, secure in the knowledge that the invalidity of the patent may be urged when the licensor sues for unpaid royalties. *Lear, supra.* If the patent is declared invalid through the efforts and expenditures of another, no further royalties are due under the license agreement. *Drackett Chem. Co.* v. *Chamberlain Co., supra,* 63 F.2d 853. Further, if the evicted licensee is sued as an infringer, the prior adjudication of invalidity enables the licensee to secure pretrial judgment in his favor. *Blonder-Tongue, supra,* 402 U.S. 313, 91 S.Ct. 1434, 28 L.Ed.2d 788. To permit a licensee in addition to recoup royalties paid is to extend *Lear* far beyond its rationale. Congress has not seen fit to create an implied warranty of validity in license agreements. We decline to do so by judicial action." (465 F.2d at 1260).

It was a principal object of *Lear* to promote "the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain." (395 U.S. at 670). To this end, a licensee that ceases royalty payments (i.e., repudiates its license) and tests validity of the licensed patent in litigation with the licensor is freed of the royalty obligation from the date of repudiation, assuming the licensee prevails.

No policy announced in *Lear* would dictate the revolutionary rule sought by Zenith. On the contrary, such a rule would significantly frustrate the public policies promoted in *Lear.* Whereas *Lear* encourages early challenges by licensees of questionable patents, Zenith's position would encourage delay, affording licensees an incentive *not* to contest validity. Licensees would avoid costly litigation and wait for someone else to challenge their licensors' patents. The licensee would have nothing to lose by waiting, but the public, in the meantime, would suffer. Questionable patents would stand unchallenged, and wait-and-see licensees would simply pass their royalty expenses on to the public. This point was summarized by the Sixth Circuit:

> "We hold that neither equity nor public policy require that Troxel be permitted to recover the royalties it paid to Schwinn. Before entering into the licensing agreement Troxel was provided with a copy of the Schwinn patent and had access to the file history of the prosecution of that patent before the Patent Office. Troxel could have challenged the patent initially instead of taking a license. It could have done so at any time after the license agreement was executed. It failed to take this action. It waited for someone else to challenge the patent.

> Even after another litigant had undertaken the challenge and had been successful at District Court level. Troxel did not join in that challenge but instead elected to remain a royalty-paying licensee. During all this time it had the benefit of freedom from suit for infringement and agreement of Schwinn to attempt to halt unlicensed infringers. It also enjoyed freedom from liability for past infringement." (465 F.2d 1253, 1260).

The reasons which precluded *licensees* recovering past *royalties,* are even more compelling when applied to a vendor-vendee relationship.

Normally, there are relatively few patent licensees, and the amount of the royalty is specifically fixed and readily identifiable. However, where a patent owner sells the patented product, the potential number of vendees may be unlimited and there is no delineation in the purchase price of the portion attributed to the patent.

A potential vendee plaintiff could take the position that the price of the product would have been substantially less but for the patent and sue for any amount he himself decided to allocate to the patent. An apt illustration is provided by this very case where Zenith's position is that during the 17-year period from 1955 through 1972, Carter's total meprobamate sales aggregated $160,000,000.00; that except for the patent they would have been $30,000,000.00, and therefore that Zenith and others, should they choose, can sue to recover the asserted $130,000,000.00 differential, or a 433% royalty.

The creation of such enormous potential liabilities as Zenith's theory would impose, with their serious ramifications for the entire economy, going beyond even those outlined by the Sixth Circuit in *Troxel* with respect to royalties, ought not be imposed by a Court in the absence of clear legislative authority.

There are literally hundreds of millions of dollars spent annually on the purchase of patented products in the pharmaceutical field alone. If each of these purchasers had an action to recoup on the purchase price of a drug whose patent was later invalidated, it would bankrupt the entire industry. If not that, then it surely would effectively preclude manufacturers from ever disclosing in the form of a patent the results of their scientific and medical research.

The persuasive reasoning of *Troxel, Ransburg* and *Kraly* would bar Zenith's claim even if it were a licensee. The reasoning is *a fortiori* as against a purchaser.

3. The Court of Appeals correctly decided the issue of whether Zenith could maintain its unusual claim of fraud on the Patent Office. The conflict suggested is illusory.

Zenith suggests that there is a potential conflict between a "statement," i.e., Footnote 5 in the *Troxel* opinion, and the holding of the Third Circuit. Even if there was such an inconsistency, it would not rise to Rule 19(1)(b) grounds; moreover, the analysis in the Third Circuit's opinion of the cases cited in the dicta footnote in the *Troxel* opinion demonstrates beyond peradventure that any "conflict" is illusory.

The Third Circuit stated:

> "Finally, we reach Count V, which alleges a right to recovery based on Carter's claimed fraud on the Patent Office. Zenith has consistently denied in the district court and in this court that Count V derives

> from an antitrust theory. *Zenith Laboratories, Inc.* v. *Carter-Wallace, Inc.,* 64 F.R.D. 159, 168 n.4 (D. N.J. 1974). Rather, Zenith characterizes its claim as one based on common law fraud, which it contends was also the basis of the cases mentioned as still viable in the first *Troxel* appellate opinion.
>
> *The cases cited in Troxel develop essentially two common law causes of action for fraud, neither of which applies to Zenith.* First, where fraud is practiced directly on the licensee, for example, inducement by misrepresentation to enter into a licensing agreement, the licensee has a cause of action. *SCM Corporation* v. *Radio Corporation of America,* 318 F. Supp. 433 (S.D.N.Y. 1972). Second, another legally cognizable claim is for unfair competition based on the inequitable advantage that one party gains from a fraudulently obtained patent which obstructs another party's efforts to develop and market a similar product. *Struthers Scientific and International Corp.* v. *General Foods Corp.,* 334 F. Supp. 1329 (D. Del. 1971); *Corning Glass Works* v. *Anchor Hocking Glass Corp.,* 253 F. Supp. 461 (D. Del. 1966). *Zenith alleges neither that it was induced to enter a licensing agreement nor that it was prevented from realizing profits on its own drug invention.* Thus, its *bald assertion* that it deserves to recover due to Carter's alleged fraud, not on it but on the Patent Office itself, does not state a claim on which relief can be afforded."

As aptly demonstrated in the Third Circuit opinion, the authorities cited by Zenith do not support its position. What those authorities do establish is (1) that a *licensee* can recover *royalties* paid under a patent license in a normal fraud action against a patent holder who practiced

fraud *on him* in connection with the license agreement, and (2) purchasers like Zenith, as well as licensees, can recover under the antitrust laws if the patent was procured by active (not technical) fraud on the Patent Office, and the other elements of an antitrust violation are shown.

Zenith does not claim such alleged fraud created a restraint of trade under the antitrust laws, and it specifically eschews reliance upon *Walker Process Equipment* v. *Food Machinery and Chemical Corp.,* 382 U.S 172 (1965), which recognized the validity of such an antitrust claim in limited circumstances. As Zenith is alleging neither fraud on it nor an antitrust violation, it has not stated, in Count Five, a claim on which relief can be granted.

CONCLUSION

The petition states nothing which warrants review by this Court, on the basis of the considerations governing review on certiorari set forth in Rule 19 or otherwise, and there are no special or important reasons for granting the writ. Also, the decision of the Court of Appeals is correct in all respects. Accordingly, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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